Vornado® INC.

ANNUAL REPORT

FOR THE YEAR ENDED JANUARY 31,

1965

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OFFICERS

FREDERICK ZISSU, *Chairman of the Board*

MURRAY J. SIEGEL, *President and Chief Executive Officer*

JACOB STOLBACH, *Executive Vice President and Secretary*

LEO ZWIEBACH, *Vice President*

DONALD B. GOMES, *Vice President*

HERBERT ROSENBLUTH, *Treasurer*

DIRECTORS

FREDERICK ZISSU, *Chairman*

ALFRED B. AVERELL, *Partner, Bache & Co., Member New York Stock Exchange*

DR. CHARLES M. EDWARDS, JR., *Dean, New York University Institute of Retail Management*

DONALD B. GOMES, *Vice President*

MURRAY J. SIEGEL, *President*

STANLEY SIMON, *Partner, Stanley Simon and Associates*

JACOB STOLBACH, *Executive Vice President*

LEO ZWIEBACH, *Vice President*

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Joseph W. Brady
Lucille Coon
Jack Cerreto
Esther Donner
Sidney W. Goldberg
Lewis Gross
Arthur Grunwager
Frank Hall
Sam Harris
Gary E. Hubschman
Julius Isman
Paul Jeffrey
Irving Karol
Theodore Kicey
Gilbert Lasky
George Lewis
Nat Loring
George Luciano
Morton M. Magidson
Louis Mandell
Bernard Marcus
Solomon Rogoff
Joseph Seiden
Philip Sherman
Michael Tamburri
Robert Wachs
H. Robert Zimmerman

Emanuel B. Halper, *Ass't Secretary and Ass't Treasurer*

EXECUTIVE OFFICES: 174 Passaic Street, Garfield, N. J.

AUDITORS: Peat, Marwick, Mitchell & Co.

REGISTRAR: Chase Manhattan Bank

TRANSFER AGENT: Bankers Trust Company

Vornado® INC. **AND SUBSIDIARIES**

COMPARATIVE HIGHLIGHTS

	FOR THE TWELVE-MONTHS ENDED JANUARY 31		
	1965	**1964***	**1963***
Net Sales, including Leased Departments	$200,149,190	$164,777,000	$134,059,000
Leased Department Sales	11,013,969	13,804,828	15,139,390
Net Earnings Before Federal Income Taxes	8,807,917	5,053,000	4,154,000
Provision for Federal Income Taxes	4,075,000	2,345,000	1,928,000
Net Earnings	4,732,917	2,708,000	2,226,000
Net Earnings Per Share	3.61	2.07	1.70
Number of Shares Outstanding	1,310,566	1,310,593	1,310,593

*Because of the change in fiscal year ending, from August 31st to January 31st, the amounts shown for the 12 month periods ended January 31, 1964 and 1963 have been estimated by the Company for comparative purposes. Federal income taxes for 1964 and 1963 were provided for at the hypothetical rate of 46.4%.

TO OUR SHAREHOLDERS:

During the fiscal year ended January 31, 1965, Vornado achieved new records in both sales and earnings. Sales volume reached \$200,149,190, an increase of 21.5%, and net earnings advanced by 75% to \$4,732,917, or \$3.61 per share.

We continued to expand our retail selling space and merchandise handling facilities by building three new stores, expanding several existing units and by adding to our Hanover, New Jersey warehouse.

Now, in 1965, we are proceeding with the greatest expansion program in our history.

The largest unit in the chain, 200,000 square feet, was opened in Jersey City, N. J., in March 1965, as the "anchor" in a 55 acre in-city shopping center. In May of 1965 we will have a store in New York State with the opening of our 115,000 square foot in-city unit in Schenectady, N. Y. Construction has also been started on a 130,000 square foot unit in Atlantic City, N. J., scheduled to open next August. Two additional stores are contemplated before the year-end.

Our store in Woodbridge, N. J., is being expanded to accommodate lumber and garden centers. We are entering the second phase of developing our Camden County Plaza Shopping Center in Cherry Hill, N. J. with the addition of a 31,000 square foot food supermarket.

During the current fiscal year we expect to add a total of 700,000 square feet of retailing space, an increase of over 23%. To meet the needs of this planned expansion we are building a 250,000 square foot, fully automated facility to the existing Hanover, N. J. warehouse.

MURRAY J. SIEGEL
President and Chief Executive Officer

FREDERICK ZISSU
Chairman of the Board

Still further expansion is planned for *Two Guys* for the following year in a carefully programmed schedule to keep pace with the rapid growth of discount retailing.

Our program for the future is based on our consistent profitable growth in the past—a growth characterized by:

- The physical expansion and modernization of our retail and warehouse facilities.
- The broadened scope, depth and price range of our merchandise lines.
- The absorption of nearly all leased departments.
- The development of a strong, in-depth management team.
- The increased use of electronic data processing systems.
- A greatly strengthened financial base and a substantially increased cash flow.

And, while our *Two Guys* retail operations are expanding on an increasingly profitable scale, we are glad to report also, increased sales of Vornado and other national brand appliances in our wholesale division.

As we reported on March 4, 1965, the U. S. Internal Revenue Service has questioned the validity of the tax loss carry-forward resulting from the merger in 1959 of the Company and *Two Guys From Harrison, Inc.* and has disallowed our claimed tax offset against earnings for the years 1959 through 1963.

We are taking appropriate steps to contest the decision, but it is obviously impossible to predict how the issue will finally be determined. In any event, the Company's additional tax liability arising from an adverse determination would amount to approximately $5,250,000 (including accrued interest net of tax) for all years to date, and would be met from

TO OUR SHAREHOLDERS: (continued)

available funds. It would not affect current or future earnings, with the exception of possible future interest charges.

On September 20, 1964 we suffered the tragic loss of our Company's founder and our former chairman, Mr. Herbert Hubschman. His passing left us all with a deep sense of personal loss. He established many of the merchandising concepts that continue to guide our operations and contributed largely to developing our top level administrative staff as well as the capable, in-depth middle-management.

Frederick Zissu, who has been associated with the Company since its inception, serving as a director, Senior Vice President, General Counsel and Secretary, was elected to succeed Mr. Hubschman as Chairman of the Board. Murray J. Siegel, who has been associated with the Company for many years and was elected president in 1963, also assumed the duties of Chief Executive Officer. Donald B. Gomes, who has been associated with the Company since 1947, was elected a director and Vice President in charge of merchandising and sales promotion. Jacob Stolbach, Executive Vice President and a director, was elected Secretary to succeed Mr. Zissu. Leo Zwiebach continues as a Vice President in charge of real estate development and labor relations and as a director of the Company.

We look forward to the future confident in our ability to maintain Vornado's consistently profitable growth, a growth based on practices to which we have adhered through the years.

We take this occasion to thank our loyal staff of employees whose efforts have contributed so largely to the Company's success during the past year, and to express appreciation to our suppliers for their cooperation, and to the shareholders for their confidence in, and encouragement to, management.

Respectfully submitted,

FREDERICK ZISSU
Chairman of the Board

MURRAY J. SIEGEL
President and Chief Executive Officer

Jersey City, New Jersey—Two Guys 200,000 square foot store is located on Route 440 and Communipaw Avenue—the "anchor" in a 55 acre "in-city" shopping complex.

Dover, New Jersey—Two Guys 135,000 square foot store is located on Route 46.

Cherry Hill, New Jersey—Two Guys 135,000 square foot store is the leader in the Camden County Plaza shopping complex.

REVIEW OF OPERATIONS

FISCAL YEAR ENDED JANUARY 31, 1965

SALES

Net sales for the fiscal year ended January 31, 1965 amounted to $200,149,190, an increase of 21.5% over the $164,177,000 reported for the previous twelve-month period. Leased department sales for the 1965 fiscal year amounted to $11,013,969 or only 5.5% of the total as compared to 8.3% for the previous year.

We have now brought under direct ownership the lumber, home decor and all remaining automotive and hardware departments, which were formerly leased.

The $35,972,190 gain in over-all sales volume resulted not only from newly built stores but also from sales increases in existing units.

EARNINGS

Net earnings after taxes were $4,732,917, equivalent to $3.61 per share on the 1,310,566 shares of common stock outstanding. The earnings were after deductions for depreciation and amortization of $2,507,066.

On the basis of estimated figures, earnings after Federal income taxes in the previous twelve-month period ended January 31, 1964 amounted to $2,708,000, or $2.07 per share on 1,310,593 shares. Thus, during the past fiscal year, net earnings increased by 75% on a sales increase of 21.5%.

Last year we experienced a sharp increase in operating profit margins due to a number of factors:—

- Substantially increased sales volume. The Company shared in the record level of available retail dollars.
- Reduced rates of operating and administrative expenses. This resulted from maintaining tight controls of expenses as sales increased.
- Closing of 3 unprofitable food markets. The space was diverted to other departments.
- Closing of 35,000 square foot unit in Savannah Ga. This left only one unit in the chain under 100,000 square feet.
- Refining our merchandising techniques. Middle-management was strengthened for more effective operation.
- The above factors, lower financing costs and increased sales volume in higher mark-up departments also contributed to our higher profit margins.

FINANCIAL POSITION

During the year, shareholders' equity increased from $24,422,171 to $29,484,819, or $22.50 per share.

Net working capital increased from $15,245,527 to $17,164,624. The current ratio at year end was 1.74 to 1.

Long-term debt, less installments due within one year, was $15,555,954 as compared to $15,877,963 at January 31, 1964.

The sales increase, the opening of three new stores, a major warehouse addition and other improvements were all financed without issuance of capital or debt securities. We similarly anticipate financing our new expansion program with internally generated funds.

OPERATING FACILITIES

During the year three new stores were opened—Dover, N. J., Cherry Hill, N. J. and Levittown, Pa.—adding 375,000 square feet of retail space. Also, a 16,000 square foot annex was added to our Garfield store, and lumber centers were added to our Watchung and East Brunswick units. These additions brought our total retail selling area to approximately 3,000,000 square feet at year end. We also added 150,000 square feet to our Hanover, N. J. warehouse, increasing total warehousing space to approximately 1,000,000 square feet.

This view in Two Guys Jersey City Store is typical of the coordinated displays featuring giftware and jewelry for every purse and purpose.

Two Guys caters to every sports enthusiast—indoor or outdoor—from table tennis to winter or water skiing.

THE GROWTH OF Vornado® INC.

From Vornado's founding in 1949 it required nearly twelve years to achieve our first $100 million in gross sales. The next jump to $200 million took less than five years.

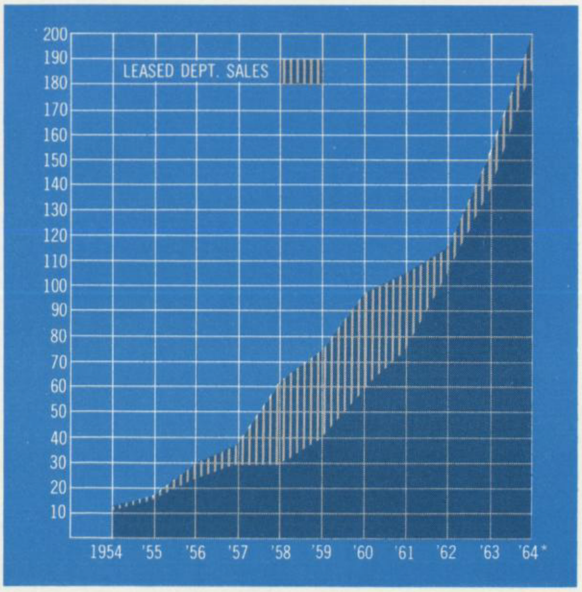
Two basic factors have contributed to Vornado's rapid development during the past several years:

One is the tremendous growth of discount retailing. In the past decade, the low markup department store has achieved acceptance. The manifest advantages offered to the buying public—in price, depth of merchandise, convenience of one-stop shopping, extended hours, and attractiveness of stores, have all contributed to this acceptance. It has received further impetus from the rapid expansion of suburban trading areas and expanded arterial highway systems, coupled with population growth and increased consumer buying power.

As a result, the modern discount store has won, and is continuing to gain, an ever-increasing proportion of the consumer goods market. Vornado, a pioneer in discount retailing, has attained a position of leadership in this field, as its record proves.

The other basic factor behind Vornado's growth is, of course, management's development of soundly conceived and executed operating policies and practices, such as:

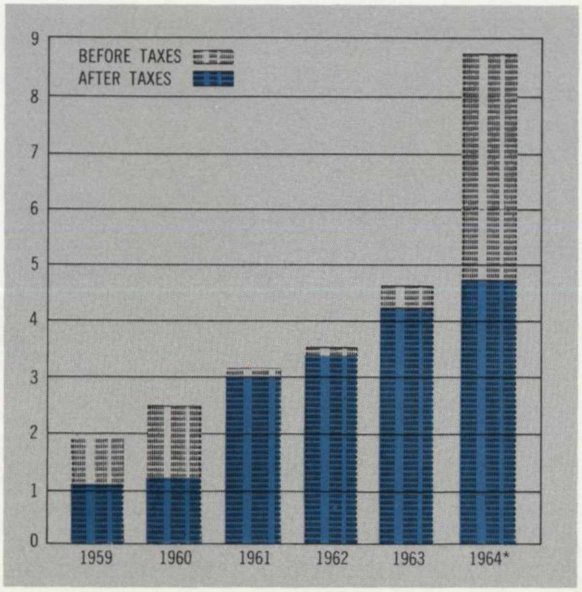
- Expansion and modernization of Vornado's physical plant, quadrupling in size the area of its selling and warehousing facilities. Today our chain of stores has approximately 3,000,000 square feet of retail selling space and 1,000,000 square feet of warehouse space.



SALES

IN MILLIONS OF DOLLARS

Vornado's annual sales volume has approximately tripled, rising from $76 million to its present rate of about $200 million.



NET EARNINGS

IN MILLIONS OF DOLLARS

Earnings, before Federal taxes, rose from $1,948,000 to $8,808,000, a gain from $2.29 per share in 1959 to $6.72 per share for the past fiscal year.

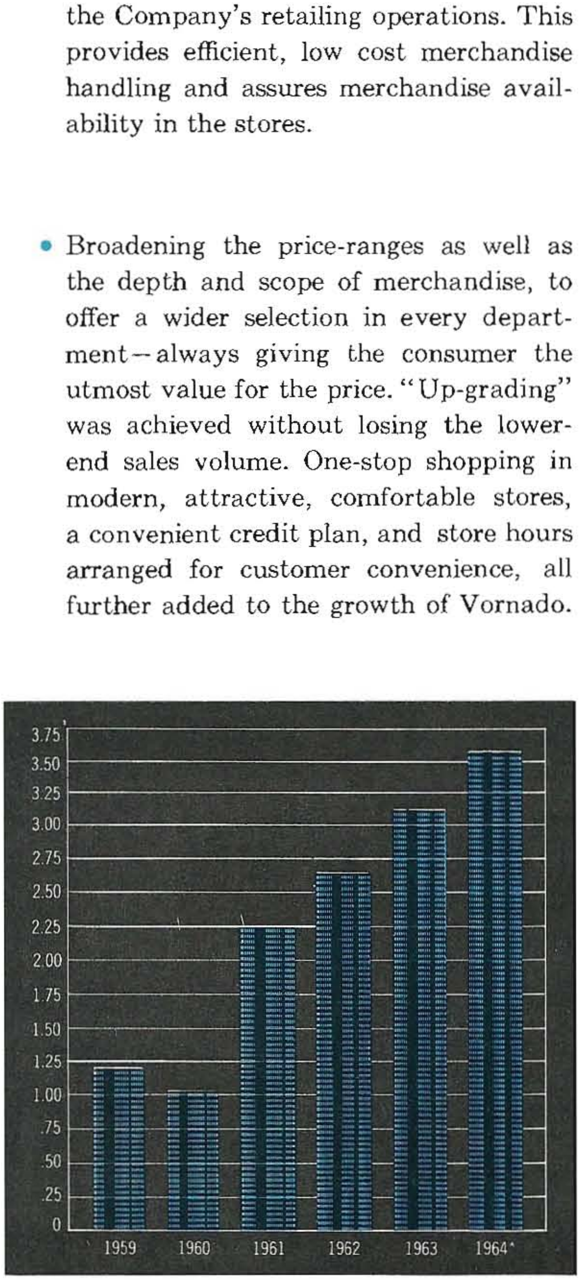
*1964 Fiscal Year ended January 31, 1965. All other Fiscal years ended August 31 in year shown.

• Establishment of centralized warehousing, and control systems which are the heart of the Company's retailing operations. This provides efficient, low cost merchandise handling and assures merchandise availability in the stores.

• Broadening the price-ranges as well as the depth and scope of merchandise, to offer a wider selection in every department—always giving the consumer the utmost value for the price. "Up-grading" was achieved without losing the lower-end sales volume. One-stop shopping in modern, attractive, comfortable stores, a convenient credit plan, and store hours arranged for customer convenience, all further added to the growth of Vornado.

• Gradual elimination of leased-department operations by bringing them under our direct ownership. In 1959 46.7% of the then annual sales volume of approximately $76 million was derived from leased departments. In the past fiscal year only 5.5% of the $200 million gross volume represented leased department sales. Under Vornado's direct management every one of these departments showed consistent, substantial increases in both sales and profit margins.

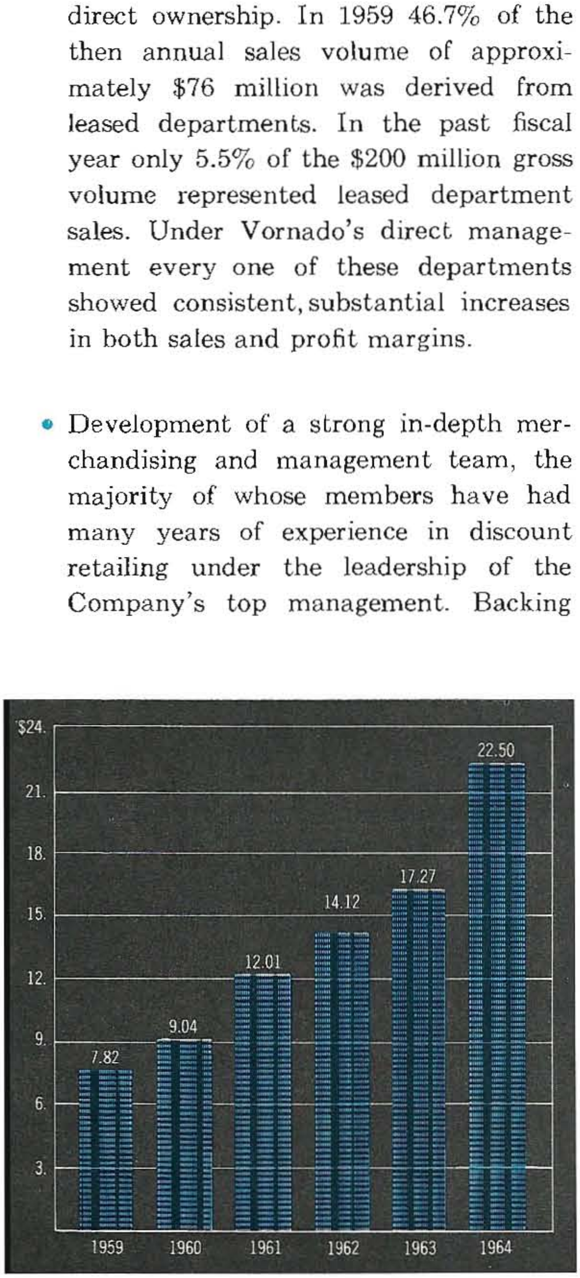
• Development of a strong in-depth merchandising and management team, the majority of whose members have had many years of experience in discount retailing under the leadership of the Company's top management. Backing



EARNINGS PER SHARE (AFTER TAXES)

based on average number of shares outstanding during the year

Earnings per share, after taxes, for the fiscal year ended January 31, 1965 rose to $3.61, as compared to $3.15 for the fiscal year ended August 31, 1963.



BOOK VALUE PER SHARE

based on average number of shares outstanding during the year

The shareholders' equity has grown from $6,661,000 to $29,485,000, an increase of 342.6%, representing a rise in book value per share from $7.82 to $22.50.

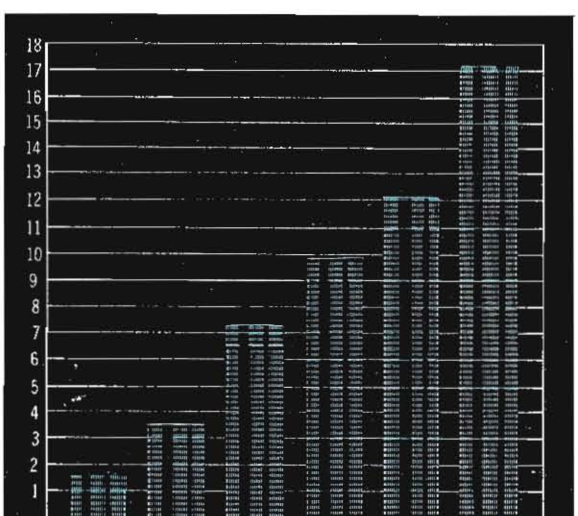
this, the Company has an expanded, on-the-job management training program, bringing promising personnel up from the ranks and specialized personnel from outside where needed.

- Increased use of electronic data processing systems to provide management with up-dated information on warehouse and store inventories, sale of goods, and operational cost factors, enabling management to effectively control costs and keep inventories at proper levels. This also has resulted in more efficient operating methods and a speedier flow of merchandise into the stores.

- Centralized sales-promotion and advertising with a complete, self-contained department to achieve maximum promotional flexibility at reduced cost. Shortening "deadlines" and using regional promotions, adjusted to geographic and climatic conditions, it meets the needs of modern mass merchandising, providing the maximum number of effective reader impressions per dollar.

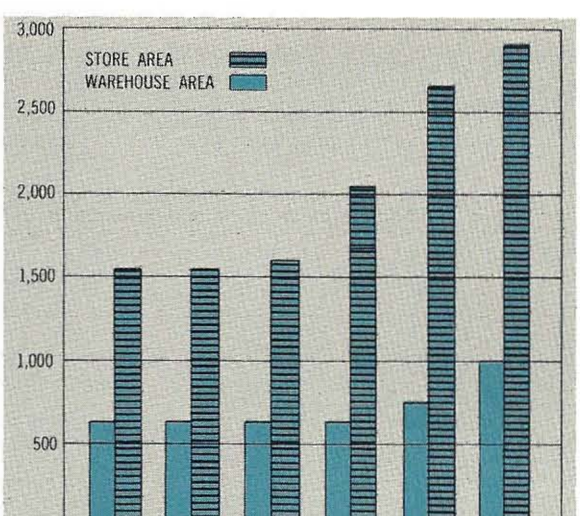
- Operation of in-house departments of specialists in real estate acquisition, store planning, design and construction, whose know-how and experience is geared to the Company's overall merchandising policies and expansion plans. This has reduced our cost-of-occupancy in new units and enabled the Company to maintain a constant modernization program in all units at minimum cost.

Tangible evidence of the effectiveness of these policies is provided by Vornado's growth during the past six years as shown by the various charts and the six-year statistical summary following.



NET WORKING CAPITAL
IN MILLIONS OF DOLLARS

The amount of net working capital increased from $1,532,000 to $17,165,000, an increase of 1020%.



SELLING AND WAREHOUSE AREA*
IN SQUARE FEET (000 OMITTED)

Retailing area expanded from 1,520,000 square feet in 1959 to 2,924,000 square feet while warehouse facilities increased from 665,000 square feet to 1,000,000 square feet.

*Square footages and number of stores at end of calendar year shown.

*1964 Fiscal year ended January 31, 1965. All other Fiscal years ended August 31 in year shown.

The hardware and lumber departments offer wide selections of merchandise conveniently displayed for easy shopping.

Two Guys food supermarkets offer a choice selection of meats, produce, groceries, frozen foods, etc., in clean, attractive food cases and well kept displays, with wide aisles for shopping convenience.

Vornado® INC. AND SUBSIDIARIES

	JANUARY 31 **1965**	JANUARY 31 **1964**
ASSETS		
Current Assets:		
Cash	$ 7,076,339	6,816,908
Receivables:		
Trade	1,334,967	1,506,145
Recoverable Construction Costs	1,300,000	—
Other	407,376	120,514
Total Receivables	3,042,343	1,626,659
Merchandise Inventory, at Lower of Cost or Realizable Market	29,767,112	25,698,097
Prepaid Expenses	485,880	296,572
Total Current Assets	40,371,674	34,438,236
Other Assets:		
Mortgages Receivable, Less Installments Due Within One Year and Reserve (Note 1)	2,174,038	2,343,476
Rent, Utility and Other Deposits (Note 1)	1,206,007	932,023
Miscellaneous	239,182	305,234
	3,619,227	3,580,733
Property and Equipment, at Cost (Notes 1, 2, 3 and 4):		
Land, Parking Areas and Buildings	12,937,163	12,989,329
Furniture, Equipment and Leasehold Improvements and Costs	14,798,513	12,123,875
Construction in Progress	1,861,225	3,315
	29,596,901	25,116,519
Less Accumulated Depreciation and Amortization	6,568,501	5,323,220
Net Property and Equipment	23,028,400	19,793,299
Cost of Leases and Occupancy Rights, Less Accumulated Amortization of $683,192 ($560,529 in 1964) (Note 2)	1,029,808	1,247,671
Debt Discount and Expense	1,009,322	1,089,092
	$69,058,431	60,149,031

See accompanying notes to consolidated financial statements.

CONSOLIDATED BALANCE SHEET
JANUARY 31, 1965 AND 1964

	JANUARY 31 1965	JANUARY 31 1964
LIABILITIES		
Current Liabilities:		
Notes Payable	$ 1,238,348	2,064,637
Long-Term Debt Installments Due in One Year	1,370,761	1,307,571
Accounts Payable, Trade	14,045,299	12,422,829
Federal Income Taxes, Estimated (Note 2)	3,779,906	1,662,273
Other, Including Accruals	2,772,736	1,735,399
Total Current Liabilities	23,207,050	19,192,709
Leased Department Rental and Other Security Deposits	458,890	363,658
Long-Term Debt (Note 4):		
5% Convertible Subordinated Debentures	5,237,000	5,237,000
3.10% Junior Subordinated Note	2,217,000	2,259,000
Other	9,472,715	9,689,534
	16,926,715	17,185,534
Less Installments Due Within One Year	1,370,761	1,307,571
Total Long-Term Debt	15,555,954	15,877,963
Deferred Federal Income Tax (Note 2)	351,718	292,530
Stockholders' Equity:		
Common Stock of 10¢ Par Value Per Share. Authorized 2,500,000 Shares; Issued and Outstanding, Including Treasury Shares, 1,317,593 (Note 6)	131,759	131,759
Additional Paid-in Capital (Including Capital Arising in Reorganization)	16,046,207	16,046,207
Retained Earnings	13,377,661	8,314,205
	29,555,627	24,492,171
Less Cost of 7,027 Shares of Common Stock Held In Treasury (7,000 in 1964)	70,808	70,000
Total Stockholders' Equity	29,484,819	24,422,171
Contingent Liabilities and Commitments (Notes 2, 3 and 7)		
	$69,058,431	60,149,031

STATEMENT OF CONSOLIDATED EARNINGS

Year Ended January 31, 1965

Net Sales, Including Leased Departments	$200,149,190
INCOME:	
Net Sales, Exclusive of Leased Departments	189,135,221
Other Operating Revenues, Less Allocated Expenses	1,517,487
Total Income	190,652,708
COSTS AND EXPENSES:	
Cost of Goods Sold	143,308,103
Operating and Administrative Expenses, exclusive of those shown below (Note 5)	30,159,951
Depreciation and Amortization	2,507,066
Taxes, Other than Federal Income Taxes	2,666,167
Rent	2,160,080
Interest and Debt Expense	1,043,424
Total Costs and Expenses	181,844,791
Earnings Before Federal Income Taxes	8,807,917
Federal Income Taxes, Estimated (Note 2)	4,075,000
Net Earnings	$ 4,732,917

STATEMENT OF CONSOLIDATED RETAINED EARNINGS

Year Ended January 31, 1965

Balance at Beginning of Year	$ 8,314,205
Add:	
Net Earnings for the Year	4,732,917
Unamortized Investment Credit, Previously Deferred (Note 2)	330,539
Balance at End of Year	$ 13,377,661

SUMMARY OF CHANGES IN WORKING CAPITAL

Year Ended January 31, 1965

SOURCE OF FUNDS:	
Net Earnings	$ 4,732,917
Adjustments for Non-Cash Items Charged to Net Earnings:	
Depreciation and Amortization	2,507,066
Debt Expense Amortized	79,142
Total From Operations	7,319,125
Sales of Properties Under Leaseback Agreements	5,500,000
	$ 12,819,125
APPLICATION OF FUNDS:	
Additions to Property and Equipment	10,249,319
Increase in Rent Security and Other Deposits	273,984
Cost of Purchased Leases	167,500
Other, Net	209,225
	10,900,028
Increase in Working Capital	1,919,097
	$ 12,819,125

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JANUARY 31, 1965

(1) Mortgages receivable:

Mortgages receivable, net of installments due within one year and bearing interest at rates of 5% and 6% per annum are as follows:

Affiliated co-partnerships	$3,789,725
Held by others	530,771
	4,320,496
Less reserve	2,146,458
Net mortgages receivable	$2,174,038

The mortgage balances result primarily from three sale and leaseback transactions with an officer and affiliated co-partnerships during 1961. The selling price of these properties (satisfied in part by purchase money mortgages providing for amortization to commence in five years) was $1,609,898 in excess of the depreciated cost. As the terms of the sales and leasebacks provide repurchase options during the five years 1966 to 1971 at the original selling prices, the excess has been applied as a reserve against the face amount of the mortgages receivable. Also, an additional reserve is being provided by an annual charge to earnings which is equivalent to the depreciation, net of future tax benefit, that would have been provided on such properties had they not been sold. Should the properties be repurchased the charge in lieu of depreciation will be included in the accumulated depreciation accounts or will provide a means of equalizing annual rentals should the properties not be repurchased.

These properties were leased back in 1961 for periods of twenty and twenty-five years at annual rentals (exclusive of taxes, insurance, maintenance, etc.), of $495,000 for the first five years and $745,000, $970,000, $1,195,000 and $920,000, respectively, for each of the succeeding five-year periods. The leases also provide for the payment of security deposits of approximately $770,000 during the next five years which amount approximates the amortization payments on mortgage debt assumed by the lessor during such period.

(2) Federal income taxes:

The Company has received a report on examination of its Federal income tax returns for the taxable years ended in 1959 and 1960. The report alleges deficiencies based primarily on disallowance of deductions claimed in those years for net operating losses incurred by the Company prior to its merger with *Two Guys From Harrison, Inc.*, and carried forward to the years examined. Similar deductions were claimed on the Company's income tax returns for its 1961-1963 taxable years. It is estimated that if similar adjustments to taxable income were to be proposed for all of the taxable years which would be affected by such disallowances, the alleged deficiencies for all years, including interest accumulations to date net of tax, would amount to approximately $5,250,000. The Company intends to resist assessment of additional tax liabilities with respect to these matters. However, the agent's allegations involve complex technical problems, and the amount of liability which will ultimately be determined for the years involved cannot be estimated at this time, and accordingly no provision therefor has been made.

The provision for Federal income taxes includes a tax reduction of $261,000 resulting from the difference between the amortizable value of occupancy rights and leases for tax and financial statement purposes which represents a permanent tax benefit. In addition, a temporary tax advantage results from the use of a tax amortization period which is shorter than that used for financial statement purposes. The provision for Federal income taxes includes an amount for taxes temporarily so deferred and is reduced by the expected future tax benefit in connection with the charge in lieu of depreciation mentioned in note 1 and the unpaid portion of amounts charged against earnings referred to in note 5.

As a result of the Revenue Act of 1964 the investment credit, which was previously deferred, has been credited to retained earnings and the amount of the credit for the current year has been applied in reduction of the provision for Federal income taxes. The change in method had no material effect on the reported earnings.

(3) Long-term leases:

During the year ended January 31, 1965, the Company sold at approximate cost and leased back three of its stores at annual rentals of $406,000 which rents were calculated to amortize the debt of the lessor (cost of the properties) including interest, over the twenty-five year term of the leases.

Substantially all of the leases covering certain of the Company's stores, warehouses and other properties, including those mentioned above and in note 1 are long-term in nature and had an average unexpired term of nineteen years at January 31, 1965. Average annual rentals during the next five years, exclusive of taxes, insurance and maintenance, approximate $2,230,000 per annum.

(4) Long-term debt:

The 5% Convertible Subordinated Debentures are due March 1, 1982 and are convertible into shares of common stock of the Company at a conversion price per share of $42.50, if converted prior to March 1, 1968, and at $49.00 per share thereafter. Mandatory annual sinking fund payments of $100,000 commence on March 1, 1968, for a period of five years and thereafter at the rate of 10% of the principal amount outstanding on September 1, 1972. The principal amount of debentures converted subsequent to September 1, 1967, may, subject to some limitations, be applied in reduction of the sinking fund obligations due thereafter. The debentures may be redeemed at gradually decreasing redemption prices ranging from approximately 105% of principal amount to face amount after February 28, 1981.

The 3.10% Junior Subordinated Note due May 1, 1976 provides for annual fixed sinking fund payments; $43,000 for the next fiscal year and in increasing annual amounts to $59,000 due on May 1, 1975, with the balance of $1,660,000 payable on May 1, 1976. The note contains prepayment and repurchase provisions.

Other long-term debt of the Company and its subsidiaries consists of first and second mortgages on real property, notes payable secured by conditional sales contracts on equipment and notes payable to others, including the indebtedness of $862,500 (before tax benefit of $294,000)

resulting from agreements with and relating to former officer-directors mentioned in note 5, at interest rates varying between 3% and 6%.

The book value of property pledged under mortgages, conditional sales contracts and notes secured by trust receipts amounted to approximately $9,210,000 at January 31, 1965.

(5) Agreements relating to former officer-directors:

At the date of his death Mr. Herbert Hubschman, former Chairman of the Board and Director, had an employment agreement with the Company providing for annual remuneration of $75,000 to June 30, 1969. The agreement provided for continuance of payments to expiration date in the event of his death at which time the unpaid amount under the contract was $350,000. In addition, Mr. Hubschman held stock options for 25,000 shares of the Company's common stock (15,000 shares at $20.15 and 10,000 shares at $20.77). By agreement with the Estate of Herbert Hubschman, the Company acquired the options at a price of $250,000, evidenced by a subordinated note, payable in equal annual installments of $31,250 with interest at 3%. Additionally an agreement was reached to extend the term of payment under the employment contract by reducing monthly payments from $6,250 to $3,125.

As of January 31, 1965, the Company provided for its obligations to Mr. Sidney Hubschman, former President and Director (amounting to $4,687.50 per month payable to December 1969) for relinquishing his rights under an employment contract, giving up certain stock options and agreeing not to compete with the Company for a specified period of time.

The aggregate of the amounts mentioned above of $871,875 has been included in operating and administrative expenses in the accompanying statement of earnings. The related liability as of January 31, 1965, net of the anticipated future tax benefit, is included in other long-term debt.

(6) Stock options and warrants:

As of January 31, 1965, shares of stock were reserved for warrants, options, conversions, etc., as follows:

Description		Shares Presently Exercisable	No. of Shares
Purchase warrant at $16.00 per share, exercisable only in its entirety and expires on April 27, 1967			42,000
Stock options to officers and key employees:			
Option Price	**Expiration Date**		
$15.57	Mar. 1, 1971	30,000	30,000
15.57	May 8, 1972	2,800	7,000
19.00(a) (b)	Feb. 1, 1969	—	63,500
19.06	Jan. 1, 1973	13,332	20,000
22.07	Jan. 1, 1968	16,666	25,000
23.32(a)	Feb. 1, 1969	—	16,250
31.75(a)	Dec. 1, 1969	—	25,000
		62,798	186,750
(No options were exercised during the year ended January 31, 1965)			
Reserved for conversion of 5% Convertible Subordinated Debentures (123,224 shares required during the period March 1, 1965 to March 1, 1968)			141,541
			370,291

(a) Qualified stock options granted during the year at 100% of market price at date of grant. The options are exercisable on a cumulative basis to the extent of 60% of the shares on or after June 10, 1965, an additional 20% on or after June 10, 1966 and all of the shares on or after June 10, 1967. These options are subject to stockholder approval.

(b) Granted in place of options at $27.60 which were cancelled.

(7) Contingent liabilities and commitments:

Guarantees:

The Company is contingently liable for payments under certain mortgages relating to properties sold under sale and leaseback transactions in prior years. As of January 31, 1965, such mortgages had unpaid balances of approximately $1,602,000. In the opinion of management, the possibility of any loss related to these mortgages is extremely remote.

The Company is contingently liable under letters of credit in the amount of $463,000 and other guarantees in the amount of $421,000.

ACCOUNTANTS' REPORT

Peat, Marwick, Mitchell & Co., Certified Public Accountants
1180 Raymond Boulevard, Newark, New Jersey

TO THE STOCKHOLDERS AND BOARD OF DIRECTORS,
VORNADO, INC.:

We have examined the consolidated balance sheet of Vornado, Inc. (a Kansas corporation) and subsidiaries as of January 31, 1965 and the related statements of consolidated earnings and retained earnings for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, subject to the final determination of the net operating loss carry-forward as an offset against taxable earnings in prior years (see Note 2 of Notes to Consolidated Financial Statements), the accompanying consolidated balance sheet and related statements of consolidated earnings and retained earnings present fairly the consolidated financial position of Vornado, Inc. and subsidiaries at January 31, 1965 and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Also, in our opinion, the accompanying summary of changes in working capital presents fairly the information shown therein.

Newark, N. J.
April 1, 1965

Peat, Marwick, Mitchell & Co.

Apparel is carried and displayed in depth, offering customers a wide choice in price and style.

Youngsters find everything they need to dress for school, play or special occasions in Two Guys boys' clothing department.

Vornado® INC. AND SUBSIDIARIES

000—Omitted

Assets and Capital

Net Working Capital
Working Capital Ratio
Property and Equipment at cost
Property and Equipment after Depreciation
Long Term Debt
Shareholders' Equity
Equity per share

Operating Results

Net Sales, including Leased Departments
Net Sales, exclusive of Leased Departments
Net Sales, Leased Departments
Percentage of Leased Department Sales to Total
Depreciation and Amortization
Net Earnings (before Federal Income Tax)
Provision for Federal Income Tax
Net Earnings after Taxes
Pre-tax Earnings Per Share
Earnings after Taxes Per Share
Number of Shares Outstanding[1]

Facilities

Number of Stores
Total Store Area (square feet)[3]
Warehouse Area (square feet)

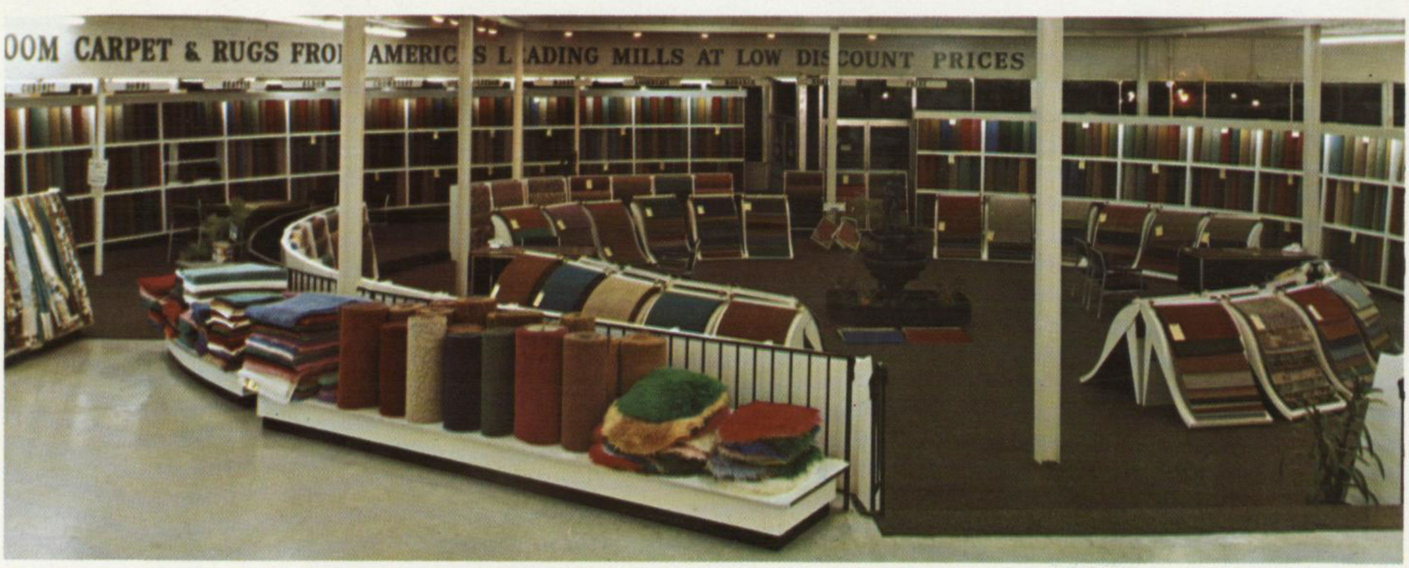
[1] Average number of shares outstanding during the year
[2] Adjusted to reflect 5% stock dividend in 1960
[3] At end of calendar year

SIX YEAR FINANCIAL AND STATISTICAL HIGHLIGHTS‡

1964*	**1963****	**1962****	**1961****	**1960****	**1959****
17,165	12,025	9,943	7,320	3,570	1,532
1.74-1	1.52-1	1.49-1	1.52-1	1.33-1	1.15-1
29,597	26,184	20,121	11,766	16,104	13,585
23,028	21,397	16,784	9,514	14,354	12,564
15,556	16,153	13,814	7,061	7,561	7,836
29,485	22,637	18,506	15,005	10,568	6,661
$ 22.50	$ 17.27	$ 14.12	$ 12.01	$ 9.04	$ 7.82
200,149	154,425	115,124	105,094	99,142	76,054
189,135	139,340	99,056	74,553	58,118	40,488
11,014	15,085	16,068	30,541	41,024	35,566
5.5%	9.7%	13.9%	29%	41.3%	46.7%
2,507	1,858	1,356	891	875	424
8,808	4,640	3,559	3,071	2,460	1,948
4,075	510	58	18	715	900
4,733	4,130	3,501	3,053	1,179	1,048
$ 6.72	$ 3.54	$ 2.72	$ 2.45	$ 2.11	$ 2.29
$ 3.61	$ 3.15	$ 2.67	$ 2.44	$ 1.01	$ 1.23[2]
1,310,566	1,310,593	1,310,593	1,249,407	1,168,260	852,075
21	21	19	16	15	15
2,924,000	2,603,000	2,195,000	1,565,000	1,520,000	1,520,000
1,000,000	750,000	665,000	665,000	665,000	665,000

* Fiscal year ended January 31, 1965
** Fiscal year ended August 31, in year shown
‡ Audited figures for the 5 months ending January 31, 1964 have been omitted because comparative figures are not available. In January, 1964, the fiscal year ending was changed from August 31 to January 31.

This mannikin display greets the customer entering the Jersey City Store—dramatizing Two Guys array of fashions.



Floor covering customers choose from a wide variety and broad range of floor coverings, as shown in this attractive display in Two Guys Totowa Store.

Two Guys STORES

Location	Square Foot Area
Allentown, Pennsylvania	140,000
Baltimore, Maryland	122,000
Bordentown, New Jersey	159,000
Cherry Hill, New Jersey	135,000
Dover, New Jersey	135,000
East Brunswick, New Jersey	140,000
East Hanover, New Jersey*	160,000
Garfield, New Jersey*	101,000
Glen Burnie, Maryland	112,000
Hackensack, New Jersey	164,000
Kearney, New Jersey	187,000
Levittown, Pennsylvania	105,000
Middletown, New Jersey	134,000
Neptune, New Jersey	60,000
North Bergen, New Jersey	143,000
Reading, Pennsylvania	122,000
Richmond, Virginia	122,000
Totowa, New Jersey*	187,000
Union, New Jersey	183,000
Watchung, New Jersey*	144,000
Woodbridge, New Jersey	169,000
Total	2,924,000
Jersey City, New Jersey†	200,000
Schenectady, New York**	115,000
Atlantic City, New Jersey**	130,000

† Opened after the close of the Fiscal year

* Two buildings

** Under construction

MERCHANDISE DEPARTMENTS

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APPAREL FOR THE ENTIRE FAMILY
AUTO ACCESSORIES
CAMERAS AND PHOTOGRAPHIC EQUIPMENT
CANDY
COSMETICS
ELECTRICAL APPLIANCES
FLOOR COVERINGS
FOOD SUPERMARKET
FURNITURE
GIFTWARE
HOBBY
HOME FURNISHINGS
HOME IMPROVEMENTS
HOUSEWARES
JUVENILE FURNITURE
LAMPS
LAWN & PATIO FURNITURE
LIGHTING FIXTURES
LINENS—DOMESTICS
LIQUOR
LUMBER
MILLINERY
NOTIONS
PETS
PLANTS
RADIO, STEREO & HI-FI
RECORDS
SEASONAL
SHOES
SHRUBS & GARDEN SUPPLIES
SPORTING GOODS
TELEVISION
TOBACCO
TOILETRIES
TOYS
VITAMINS
WATCHES—JEWELRY

Two Guys

DISCOUNT DEPARTMENT STORES

NEW JERSEY NEW YORK PENNSYLVANIA MARYLAND VIRGINIA